No. 03-250

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

AMERICA WEST HOLDINGS CORP., AMERICA WEST AIRLINES, INC., TEXAS PACIFIC GROUP, INC., TPG GENPAR LP, TPG PARTNERS LP, TPG ADVISORS, INC., CONTINENTAL AIRLINES INC., WILLIAM A. FRANKE, RICHARD R. GOODMANSON, RONALD A. ARAMINI, JOHN R. GAREL, W. DOUGLAS PARKER, MICHAEL R. CARREON, C.A. HOWLETT, STEPHEN F. BOLLENBACH, FRANK B. RYAN, JOHN F. FRASER, JAMES G. COULTER and RICHARD P. SCHIFTER,

Petitioners,

v.

EMPLOYER-TEAMSTERS JOINT COUNCIL NO. 84 PENSION TRUST FUND, *et al.*, On Behalf of Themselves and All Others Similarly Situated,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the Ninth Circuit correctly rejected petitioners' proposed "bright line rule" to determine materiality based solely on stock price movement, instead engaging in a "fact-specific inquiry" (including price), as required by *Basic Inc. v. Levinson*, 485 U.S. 224, 240 (1988), in holding that respondents sufficiently pled the materiality of petitioners' misrepresentations.

2. Whether the Ninth Circuit correctly found that the company's stock price could be subject to "distortions," namely petitioners' false reassurances that the company's operational problems would not adversely impact its financial results, and correctly held that when the company later disclosed the impact of those problems—a 30% decrease in expected earnings—the 31% stock price decline "further supports a finding of materiality."

PARTIES

Respondents include a labor union pension fund, Employer-Teamsters Joint Council No. 84 Pension Trust Fund,* and other investors who purchased publicly traded Class B common stock of petitioner America West Holdings Corp. between November 19, 1997 and September 3, 1998 (the "Class Period") and who, as plaintiffs and appellants below, filed a securities fraud class action against petitioners, including America West Holdings and its subsidiary America West Airlines, Inc. and America West Holdings' top officers, directors and controlling shareholders—defendant-appellees below.

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* In the caption to the petition, and in the Ninth Circuit caption (A 1) the name of the pension fund is not correctly stated. The district court caption is correct. (ER 113, 115)

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INTRODUCTION

Petitioners seek certiorari contending that the Ninth Circuit erred in rejecting a bright-line rule that materiality in a securities action is determined solely by stock price movement, and instead examined all of the circumstances sur-

rounding the defendants' misrepresentations—including their impact on the stock price.

As explained in this brief, certiorari is not warranted for three reasons:

- The Ninth Circuit decision is consistent with this Court's holding in *Basic Inc. v. Levinson*, 485 U.S. 224, 236-40 (1988) that no "bright-line rule" is "determinative of an inherently fact-specific finding such as materiality."
- The record in this case does not raise the questions presented by petitioners because the stock price did decline 4%-5% within days of partial revelations of the company's operational problems despite defendants' continued false reassurances of no material financial impact. In addition, as the Ninth Circuit found, when the full economic effect of the operational problems was disclosed—an expected 30% miss in earnings—the 31% stock price drop "further supports a finding of materiality."
- The conflict petitioners allege between the Ninth Circuit decision and other circuits does not exist because other circuits recognize that continued false reassurances—"distortions"—and other market forces can offset the effect of corrective disclosures and prevent or delay a significant decline of the stock price.

Petitioners say the Ninth Circuit held that market price reaction to misrepresentations is "irrelevant" to the determination of the materiality element of a securities fraud claim (Petition ("Pet.") 16-17), and that the Ninth Circuit's decision is based upon unspecified market "distortions" that impact stock price. (Pet. 24-27)

Petitioners misconstrued the Ninth Circuit's holding. The Ninth Circuit has consistently held that market price movement is relevant to—but not alone dispositive of—materiality. Moreover, there is no mystery about the "distortions" referenced by the Ninth Circuit. They are the

"continued" false reassurances uttered by petitioners (*i.e.*, that the operational problems would have no material financial impact on the company) which served to offset the partial corrective disclosures. (A 25-26)

STATEMENT OF THE CASE

A. America West Emerges from Bankruptcy Under Defendants' Control

In 1994, America West Holdings Corp. ("Holdings"), the parent company of America West Airlines, Inc. (collectively "America West" or the "Company") emerged from bankruptcy. (A 4; ER 115 ¶¶ 2, 43-44) Several investors, including Continental Airlines, Inc. ("Continental") and Texas Pacific Group, Inc., *et al.* ("TPG"), were involved in the reorganization plan. (A 4; ER 115 ¶ 43) As a result of the issuance to themselves of certain supervoting Class A shares, Continental and TPG, while holding less than a 10% equity interest in the Company's Class B common stock, controlled 57% of the voting power. (A 5; CR 64, Ex. O at 1, 3)

With this power, Continental and TPG selected a majority (9 of 15) of America West's Board of Directors. (A 4-5; SER 67) Continental's and TPG's control was so complete that America West's 1997 Report on Form 10-K stated: "There can be no assurance that the controlling shareholders identified above [Continental and TPG] will not seek to influence [America West] Holdings in a manner that would favor their own personal interests over the interests of the Company." (ER 115 ¶ 44)

B. To Cut Costs at the Expense of Safety, Defendants Outsourced Aircraft Maintenance Work Without Proper Oversight

On January 1, 1994, defendant William Franke became Chief Executive Officer ("CEO") of America West. Aircraft maintenance deteriorated dramatically during his tenure. (ER

115 ¶ 42(a)) Franke instituted a policy known as "don't gold plate the plane" (*i.e.*, maintenance workers should only do the minimum), and discontinued "open-door" and "self-disclosure" practices with the Federal Aviation Administration ("FAA"). (A 6-9)

In December 1995, America West fired 375 aircraft mechanics, half of its maintenance work force, and outsourced that work to Tramco. (ER 115 ¶¶ 5, 100(a)-(b)) In an internal email dated June 22, 1998, an FAA officer described the disturbing "maintenance saga" that began in December 1995, stating: "Tramco was not properly doing maintenance" and the FAA was fighting an "ongoing battle to educate [the] upper management" of America West that it "was, in fact, responsible for oversight." (A 6; ER 115 ¶ 100(b))

After stumbling through 1996, the Company assured investors and passengers that its maintenance and operational problems were on the mend. (ER 115 ¶¶ 9, 88(c), (d)) Throughout 1997, however, the FAA continued to conduct inspections, find violations and issue warnings to America West regarding its maintenance operations. (ER 115 ¶¶ 56, 100) In a January 1997 meeting with America West, the FAA described these maintenance issues as a "systemic problem." (A 8-11; ER 115 ¶ 56) America West's "incident rate" was above average for the industry in the second and third quarters of 1997. (ER 115 ¶ 147(m)) Throughout this time, America West's stock price languished below $15 a share. (ER 115 ¶ 14).

C. During the Class Period, America West Sacrificed Maintenance While Falsely Assuring the Public All Was Well

In response to the stock's poor performance, TPG and Continental embarked on a scheme to raise the stock price by May 20, 1998, the date on which they could freely sell their

publicly traded stock under the Stockholders' Agreement. (A 9; ER 115 ¶¶ 3, 4, 10, 19, 47) To accomplish this goal, TPG and Continental joined forces to cause America West to buy-back tens of millions of dollars worth of the Company's stock portrayed as an "attractive investment," taking advantage of their position as majority owners who controlled the Board of Directors and related committees. (ER 115 ¶¶ 4, 19, 38, 94, 144)

In addition, America West began issuing positive statements about its operations and finances when in fact its internal operations continued to deteriorate. (ER 115 ¶¶ 14-18) On November 18, 1997, senior management told analysts that "bright revenue prospects" were ahead and that the maintenance issues caused by outsourcing were "behind the company." (A 10-11; ER 115 ¶ 90) On January 20, 1998, America West held a conference call with analysts and investors, in which Franke and Douglas Parker, the Chief Financial Officer ("CFO"), falsely stated that maintenance expenses would not increase in 1998. (A 11; ER 115 ¶ 96)

Contrary to America West's public representations, its maintenance problems, as well as the FAA's enforcement actions and warnings, continued internally. In a January 20, 1998, letter to Company President Richard Goodmanson (a member of the Board selected by TPG and Continental), and in its subsequent investigative report, the FAA charged that America West's failure to ensure the effectiveness of radio communication systems on airplanes "is indicative of the systemic problems that are deeply integrated within the airline's procedures and/or lack thereof." (A 10; ER 115 ¶ 100(l)-(m))

Similarly, in a February 9, 1998 FAA letter to Goodmanson and in its subsequent investigative report, the FAA complained that America West's lack of methods and procedures "perpetuates the attitude of this carrier's management that safety and regulatory requirements are

secondary to the continued movement of aircraft within the carrier's route system." (A 10-11; ER 115 ¶ 117(i)-(j)) The report also noted "the company's initial refusal to respond to this matter or initiate any significant action to preclude a subsequent violation in this area, after being apprised of the FAA's Certification Management Unit's findings, raises genuine concern for the continued safety of the traveling public." (ER 115 ¶ 117(j))

By failing to perform the required inspections and routine maintenance, America West achieved artificially high utilization rates, *i.e.*, the number of hours flown by an aircraft per day, which in turn increased its revenues. (A 11; ER 115 ¶¶ 15, 16, 47, 147(i)) Defendants all knew that America West would eventually bear the brunt of these deferred maintenance costs, but were determined to conceal this information long enough to allow TPG and Continental to sell nearly 100% of their Class B common stock equity interest in the Company at inflated prices. (A 11-12; ER 115 ¶¶ 16, 60, 147(e))

During this time, the stock repurchase (buy-back) scheme—designed to further inflate the stock price—was in full swing. (A 12; ER 115 ¶¶ 3, 4, 19) By January 15, 1998, America West had repurchased $20 million worth of its own securities. (ER 115 ¶ 94) During the second and third quarters of 1998, America West spent an additional $87 million repurchasing 4.2 million shares on the open market. In total, America West spent over $100 million repurchasing approximately 4.9 million shares, continuing to assure the investing public its stock was "an attractive investment." (A 11; ER 115 ¶¶ 4, 19, 94, 144)

The scheme to raise the stock price succeeded. As a result of defendants' buy-back scheme, supposed resolution of maintenance problems, and false statements about the Company's earnings, the stock hit $18-7/8 per share on December 30, 1997, its highest price in 17 months. (ER 115

¶ 93) By March 10, 1998, America West stock reached $27-1/4, the highest price since its bankruptcy reorganization. (ER 115 ¶ 101) By April 21, 1998, America West's stock soared to an all-time high of $31-5/16. (ER 115 ¶ 20) To keep the price high, in the 1997 Annual Report, released on May 4, 1998, CEO Franke and President Goodmanson stated that America West had "produced the best financial results in its history and realized substantial improvements in its operational performance." (ER 115 ¶ 118) The report also falsely emphasized that "safety will continue to be a foremost priority." *Id.*

Beginning on May 20, 1998, the first time TPG and Continental could begin selling their publicly traded Class B stock, without selling any of their Class A voting stock, TPG and its owners sold approximately 99% of their Class B stock (1,946,359 shares) at a near-peak price of $27-3/4 per share, for over $54 million. (ER 115 ¶¶ 63-66) On June 22, 1998, Continental sold all of its Class B stock (317,140 shares) at $28-1/8 per share, for over $8.9 million. *Id.* By the end of July 1998, insiders, namely TPG and Continental, had sold 2.4 million Class B shares for over $67 million—but remained in control of America West's voting Class A stock. (A 12) *See* stock chart appended to this brief. (ER 115:¶33)

D. Partial Disclosure of the Company's Problems Was Offset by Defendants' Continuing False Assurances

On June 23, 1998, the day after Continental sold its Class B stock, *The Wall Street Journal* reported that the FAA had increased its oversight of the Company: "America West face[d] the prospect of substantial federal sanctions for failing to properly oversee the work of outside maintenance contractors on its jetliners. The [FAA] is seeking to impose at least $1 million in civil penalties." (A 12; ER 115 ¶ 130) In response, however, to keep the inflation in the stock just as

the insider sales had occurred, a Company spokesperson reassured investors that enhanced FAA surveillance had not turned up any "significant maintenance or operational problems." *Id.* On June 24, 1998, Goodmanson publicly stated that the increased surveillance was just "routine FAA procedure" when an airline is involved in labor negotiations, and reiterated that "no significant maintenance or operating problems had been discovered." (ER 115 ¶ 131) Despite these false reassurances, the stock declined 4.5% over the next three days. (SER 129:6, 129:33)

Similar false reassurances occurred again following the public announcement of America West's $5 million settlement with the FAA on July 14, 1998. Defendants reassured investors that America West remained an attractive investment and that the Settlement Agreement would not have "***a material adverse effect on the Company's operations or financial results***." (A 12-13; ER 115 ¶ 134)[1] On July 21, 1998, Goodmanson continued to assert that America West was "not anticipating any major increase in maintenance costs or cost of the oversights" as a result of the Settlement Agreement. (ER 115¶139)

E. When the Expected Financial Impact of Deferred Maintenance Was Revealed, the Stock Price Dropped 31% in One Day

Despite the false assurances, the market appeared increasingly skeptical. America West's stock began to decline in late July, dropping from $29 on July 22, 1998, to $21-5/16 on August 4, 1998. (SER 129:33) To stop the bleeding, America West authorized another stock repurchase program of up to five million shares, which CEO Franke said reflected

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[1]Here, as elsewhere throughout, emphasis has been added and citations and footnotes omitted unless otherwise indicated.

the Company's belief that its stock was "an attractive investment." (ER 115 ¶ 144)

However, on September 3, 1998, America West pre-announced that it expected to miss third quarter (ending September 30) earnings estimates by 30% because of unsatisfactory operational performance. While its press release attempted to blame labor problems for the expected miss, America West acknowledged in conference calls that it had taken several costly steps to correct operational problems, including (1) purchasing additional planes, (2) increasing (from four to thirteen) the number of cities where overnight maintenance would be available, (3) increasing its inventory of spare parts, and (4) hiring more than 100 mechanics. (A 15; ER 115 ¶¶ 149-50; SER 129:19)[2] Upon these revelations, the stock price immediately fell 31%, from $20-5/16 to $14 per share. (A 15; ER 115 ¶ 151) The stock continued to fall, reaching a low of $9-5/8 in early October 1998. *Id.*

LOWER COURT PROCEEDINGS

In 1999, respondents, Employer-Teamsters Joint Council No. 84 Pension Trust Fund, a union pension fund ("Pension Fund"), filed a securities fraud class action against petitioners America West, Continental, TPG and individual senior Company officers ("defendants"), in the District of Arizona. (A 3-4) The complaint alleged that defendants made false and misleading statements to inflate America West's stock price, enabling them to engage in $67 million in insider trading. (A 3-4)

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[2] Contrary to defendants' attempt to deflect liability, such actions relate to deferred maintenance and FAA compliance—not labor negotiations. The FAA confirmed that the "labor dispute flagged regulators to potential problems, but was not the cause of them." (*See* Plaintiffs-Appellants' Request for Judicial Notice ("RJN"), Ex. 3)

The district court dismissed plaintiffs' second amended complaint. The court ruled in relevant part that the Pension Fund's allegations that defendants made false and misleading statements regarding America West's maintenance issues and finances were immaterial as a matter of law because it found the market did not immediately react to the June 23, 1998 disclosure of the FAA investigation or the July 14, 1998 disclosure of the FAA settlement and $5 million fine. (A 9, 17, 23-24, 71)

Respondents timely appealed to the Ninth Circuit, which reversed the order of dismissal in a published decision. *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. America West Holding Corp.*, 320 F.3d 920 (9th Cir. 2003). (A 1-60) The Ninth Circuit panel majority held that the defendants' misrepresentations were not immaterial as a matter of law. Applying the "fact-specific inquiry" endorsed by this Court in *Basic*, 485 U.S. at 240, the Ninth Circuit held the misrepresentations alleged satisfied the materiality pleading standard because there was a "substantial likelihood" that a "reasonable investor" would view the information about the impact of America West's maintenance costs or its finances to be "significant" in the decision to invest. (A 26) The Ninth Circuit, consistent with *Basic*, 485 U.S. at 236, rejected petitioners' proposed bright-line rule requiring an immediate decline in the Company's stock price. (A 25) Instead, the Ninth Circuit concluded that the impact on America West's stock price of the partial revelations of its FAA problems in June and late July 1998 was delayed until early September by defendants' continued false reassurances to investors—"distortions"—that the Settlement Agreement with the FAA "would not have noticeable economic effects on the company." (A 26)

Petitioners' application for *en banc* rehearing was denied. No judge "requested a vote" and only the dissenting judge voted to grant rehearing. (A 82) The dissent had fastened on

the supposed lack of market reaction to the partial disclosures as a bright-line indicator that the misrepresentations were immaterial as a matter of law. (A 51) The dissent overlooked the "distortions" in the stock price caused by defendants' continuing false reassurances which served to offset the partial revelations.

REASONS FOR DENYING THE PETITION

Certiorari is not warranted in this case. There is no conflict with *Basic* or with other circuits. The record does not support the question presented by the Petition because the stock price did decline even on the partial revelations of America West's operational problems. Further, there was an immediate 31% drop in the price when the full economic impact of the FAA settlement and the Company's operational problems was disclosed on September 3, 1998, *i.e.*, an expected 30% miss in earnings.

A. The Ninth Circuit Decision Is Consistent with *Basic*

Petitioners urge this Court to adopt a per se rule that if there has been no immediate drop in the stock price upon disclosure of bad news, the alleged misrepresentations must have been immaterial as a matter of law. The Ninth Circuit declined to adopt such a rule because it would contravene this Court's holdings in *Basic*, 485 U.S. 224, and *TSC Indus. v. Northway, Inc.*, 426 U.S. 438 (1976).

As noted by the Ninth Circuit, in *Basic* this Court expressly approved the "reasonable investor" standard set forth in *TSC Indus.* for determining materiality. *Basic*, 485 U.S. at 231-32. The Court held that a fact is material if there is a "'substantial likelihood'" that a reasonable investor would consider it important in his or her decision making. *Id.* at 231 (quoting *TSC Indus.*, 426 U.S. at 449). The Court explained that, to fulfill the materiality requirement, "'there must be a sub-

stantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.'" *Id.* at 231-32. In other words, "materiality depends on the significance the reasonable investor would place on the withheld or misrepresented information." *Id.* at 240; *see United States v. Bilzerian*, 926 F.2d 1285, 1298 (2d Cir. 1991) (absence of market price movement does not disprove materiality).

In rejecting a bright-line rule, this Court explained that "[A]ny approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be over—or under-inclusive." *Basic*, 485 U.S. at 236. This Court's reasoning compels rejection of petitioners' proposed bright-line rule requiring a stock price decline. "Materiality depends on the facts and thus is to be determined on a case-by-case basis." *Id.* at 250.

Lack of materiality is not the only conclusion that reasonably can be drawn from the lack of a significant change in a stock's price in the days following a negative disclosure. For example, a company can disclose counteracting positive information on the same day (as occurred in this case), or a friendly, influential analyst might issue a "buy" recommendation, or the information's real significance may not yet be fully understood. *See In re Control Data Corp. Sec. Litig.*, 933 F.2d 616, 619-20 (8th Cir. 1991) (falsehoods were not immaterial simply because there was no market price reaction when earnings restated; only later, when it was revealed that as a result of the restatement Control Data was in default on its loan covenants did the stock price collapse). These are issues to be explored by summary judgment or trial—not on a pleading motion. *See Basic*, 485 U.S. at 248-49 & n.29; *accord Gebhardt v. ConAgra Foods, Inc.*, 335 F.3d 824, 832 (8th Cir. 2003) (stock price movements alone are not

dispositive "absent sufficient facts and expert testimony, which cannot be considered at this procedural juncture, to put the information in its proper context"); *Blackie v. Barrack*, 524 F.2d 891, 909 n.25 (9th Cir. 1975) (fact-finder can rely on "other methods" to determine stock value "including expert testimony").

B. The Record on Appeal Does Not Raise the Question Presented in the Petition Because the Stock Price Did Decline 4%-5% on Defendants' Partial Revelations of Concealed Company Maintenance Problems and Declined 31% Later upon Disclosure of the Financial Impact of Those Problems

As noted above, in analyzing the fraud-on-the-market doctrine, the Ninth Circuit correctly declined to adopt defendants' proposed bright-line rule that an immediate price drop is the only way to determine materiality. (A 24-25) Instead, the majority engaged in a "fact-specific inquiry" as contemplated by *Basic*, 485 U.S. at 240. (A 25-26) The Ninth Circuit correctly concluded that a reasonable investor would find material the information regarding America West's deferred maintenance costs, unsafe maintenance practices and the ultimate impact of these facts on the overall financial health and earnings of the Company. *Id.*; *accord Warshaw v. Xoma Corp.*, 74 F.3d 955, 959-60 (9th Cir. 1996) (holding that a company's optimistic statements, which failed to disclose internal concerns regarding the safety of a product and thus that agency approval was unlikely, were material); *In re ValuJet, Inc., Sec. Litig.*, 984 F. Supp. 1472 (N.D. Ga. 1997) (same—airline safety).

Indeed, America West's stock price movement further supports materiality in that it increased significantly after defendants' false statements, from $14-1/2 on November 18, 1997, to $31-5/16 on April 21, 1998. (ER 115¶20)

Having determined the information pled could be deemed material, the majority turned to defendants' contention that the market failed to react when there were at least two partial disclosures of these problems. On June 23, 1998, *The Wall Street Journal* reported that America West faced the prospect of FAA sanctions for failing to properly oversee outside maintenance contractors. (A 12; ER 115 ¶ 130) On July 14, 1998, the $5 million settlement with the FAA was announced. (A 13; ER 115 ¶ 134)

Petitioners contend that on the same day of each such partial revelation, the stock price actually increased—1/8 of a point on June 23 and 3/8 on July 14. In fact, the July 14 disclosure occurred "late Tuesday night" after the market closed. (ER 115 ¶ 136). The price ***decreased*** the next day. (SER 129:33). Petitioners also ignore that the price declined 4%-5% within two to three days after each partial disclosure as shown by a trading history chart that they themselves submitted to the district court. (SER 129:33)[3] The Third and Eighth Circuits have held that a 4% price drop served to confirm that the facts concealed were material. *Oran v. Stafford*, 226 F.3d 275, 285 (3d Cir. 2000); *Gebhardt*, 335 F.3d at 831.

Moreover, petitioners fail to address at all their false reassurances that the operational problems would have ***no financial impact on the Company***. (Pet. 4-5) Because investors "naturally" rely on the statements of corporate insiders (*Virginia Bankshares v. Sandberg*, 501 U.S. 1083,

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[3] Specifically, after the June 23, 1998 *Wall Street Journal* article, America West's stock declined 4.5% over the next three days—from $28-1/8 to $26-7/8. (SER 129:6, 129:33) After the July 14, 1998 release announcing the FAA settlement, America West's stock declined 5.8% over the next two days—from $30-1/4 to $28-1/2. (SER 129:33) In *Basic*, this Court stated "we do not intend conclusively to adopt any particular theory of how quickly and completely publicly available information is reflected in the market price." *Basic*, 485 U.S. at 249 n.28.

1090-91, 1093 (1991)), such false reassurances—"distortions"—explain why the stock price did not totally collapse on each partial disclosure.

As the Ninth Circuit observed, with the June 23, 1998, *Wall Street Journal* disclosure, America West falsely asserted that "'enhanced surveillance [by FAA] hasn't turned up any "significant maintenance or operational problems."'" (A 13; ER 115 ¶ 130) With the July 14, 1998, FAA settlement announcement, America West falsely claimed "'that the settlement agreement's provisions will not have ***a material adverse affect on the Company's operations or financial results***.'" (A 14; ER 115 ¶ 135) The complaint specifically alleges that America West's misleading "reassurances" helped maintain the stock price. (ER 115 ¶¶ 32, 37)

As explained in *Blackie*, 524 F.2d 891, "the drop after a corrective disclosure will not be conclusive of the amount of original inflation, both because the correction may be only partial (as is alleged of the major corrections involved here), and because the prolonged nature of the fraud introduces other market variables which may affect the amount the market reacted to disclosures at different times during the class period." *Id.* at 909 n.25.[4]

This case, too, involved partial disclosures and a prolonged fraud. The Ninth Circuit recognized that the market is subject to "distortions" that prevent the ideal of "a free and open public market" from occurring. (*Id.* at 246; A 25) There is no mystery about the "distortions"—they are the continued false reassurances uttered by America West to neutralize the adverse news about the FAA settlement and to prop up the stock price. (A 26) Contrary to petitioners' assertion (Pet. 7 n.3), and that of the dissenting judge (A 57 n.1), plaintiffs did allege such "distortions." As the panel majority recognized, plaintiffs alleged that defendants' false assurances "that the

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[4] *Blackie* is cited with approval in *Basic*. 485 U.S. at 244-45, 247 n.25.

settlement agreement and compliance therewith would not have noticeable economic effects on the company" served to prop up the stock price. (A 26; ER 115 ¶¶ 130-37)

This analysis is consistent with *Basic*. There, this Court recognized that "'artificial manipulation'" and "'the hiding and secreting of important information'" serve to obstruct or upset the "'true function of an open market.'" *Basic*, 485 U.S. at 246. America West's false reassurances coupled with the buy-back scheme are just such manipulative distortions.

More to the point, when defendants disclosed the anticipated economic effect of the ongoing maintenance problems on September 3, 1998, an expected 30% miss in earnings, America West's stock price collapsed—dropping 31% in one day—from $20 to $14. (A 14-15; ER 115 ¶¶ 150-51) As the Ninth Circuit found, this price drop "further supports a finding of materiality." (A 26)

Accordingly, the record here does not raise the questions presented by the Petition, which are premised on the supposed absence of a stock price movement. Here, the stock price went up on defendants' false statements and implementation of the buy back scheme and partially declined despite continued false reassurance preventing the stock's immediate collapse. When the economic effect of the operational problems and FAA settlement was disclosed to the market, the stock did in fact collapse—dropping 31%.

C. The Conflict Alleged Between the Ninth Circuit Decision and Other Circuits Does Not Exist

Petitioners also contend that the Third Circuit has fashioned a "special rule" for measuring materiality that holds misrepresentations immaterial as a matter of law where disclosure of the truth has no negative effect on stock price. (Pet. 14-15) Petitioners claim the Fifth Circuit likewise follows such a bright-line rule. (Pet. 15)

The cases relied on by petitioners are, upon closer analysis, not in conflict with the Ninth Circuit decision. Indeed, both the Third and Fifth Circuits recognized that the absence of stock price changes could in other cases be explained by other market forces and defendants' continuing false assurances.

In *Oran*, 226 F.3d at 283, for example, the Third Circuit recognized that false assurances could neutralize (*i.e.*, distort) the bad news disclosed, but found the assurances or "spin" alleged in that case were not inaccurate. *Id.* Similarly, the Fifth Circuit in *Nathenson v. Zonagen Inc.*, 267 F.3d 400 (5th Cir. 2001), recognized that market forces and company-specific news which it labeled "special circumstances" could offset the immediate effect of false statements on a stock's price:

> We also realize that in certain special circumstances public statements falsely stating information which is important to the value of a company's stock traded on an efficient market may affect the price of the stock even though the stock's market price does not soon thereafter change.

Id. at 419. The Fifth Circuit added that "no such special circumstance is alleged or even hinted at here." *Id.*[5]

By contrast, in this case, respondents expressly cited the continuing false assurances by petitioners as the reason why America West's stock price did not immediately collapse upon partial revelation of its maintenance problems. (ER 115 ¶¶ 130-37) Respondents further detailed how just weeks later, upon disclosure of the serious financial impact of those problems, America West stock fell 31% in one day. (ER 115 ¶ 151)

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[5] As petitioners tacitly concede, the First and Fourth Circuit cases they cite do not hold that market price reaction is dispositive. (Pet. 9, 13-14 n.6) Such a holding would contravene *Basic*, where this Court held that no "single fact or occurrence" is dispositive. 485 U.S. at 236.

In sum, the Ninth Circuit did not hold that stock price reaction was irrelevant to materiality—as the petition claims. (Pet. 16-17) Rather, the Ninth Circuit has consistently held that a decline in stock price is relevant but not necessarily dispositive: "[T]he drop [in price] after a corrective disclosure will not be conclusive of the amount of the original inflation, both because the correction may only be partial (as is alleged of the major corrections involved here), and because the prolonged nature of the fraud introduces other market variables which may affect the amount the market reacted to disclosures at different times during the class period." *Blackie*, 524 F.2d at 909 n.25; *accord Wool v. Tandem Computers, Inc.*, 818 F.2d 1433, 1437 (9th Cir. 1987); *Knapp v. Ernst & Whinney*, 90 F.3d 1431, 1438 (9th Cir. 1996). The scenario anticipated in *Blackie* is exactly what happened in this case. There were partial disclosures ***and*** continuing false reassurances explaining the stock price's delayed reaction. The Ninth Circuit correctly held that the ensuing 31% price drop was relevant as further support for "a finding of materiality." (A 26).[6]

[6] Contrary to petitioners' assertion, the Eighth Circuit also considers stock price movement—there 4%—as relevant, but not alone "dispositive." *Gebhardt*, 835 F.3d at 831-32.

CONCLUSION

For the foregoing reasons, the petition should be denied.

Respectfully submitted,

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